David v Goliath: What's next for LNG?

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25/09/2017

A fierce debate over the next LNG projects in North America (and whether there's any need for further incremental supply) is under way, and at the heart of the argument is the question of whether the next LNG project will be another Goliath project or a smaller, modular facility.

As it turns out, the answer may be all of the above.

With no fundamental change, the world's LNG supply chain appears to be well-fed without much need for further supply, as evinced by the recent cancelation of the C$30 billion Pacific LNG project in British Columbia. But that could all change very quickly as China moves toward its goal of replacing 50% of its coal-fired generation fleet with cleaner natural gas-fired plants.

Soft coup

As it stands, the only buyers of LNG in China at the moment are the national oil companies, and they charge a massive premium to the power producers who need the product to run their operations. If President Xi Jinping has his way, however, that would not be the case.

Jinping is said to be pushing hard to reforms the infrastructure and process of bringing LNG into the country. As part of that push, there is an effort under way to break up the NOCs, though that is facing tough resistance. A planned break up of Sinopec into seven companies earlier this year was thwarted by management.

Even if those efforts to break up NOCs and thereby encourage price competition, it's said to be looking more and more like the power companies will be directed to buy their own LNG. In order for that to happen, the power side will need to navigate through the legalities of bypassing the NOCs. This would allow power companies to avoid paying the middle man a hefty premium, and make gas-fired generation much more economically viable. It would hence likely speed up the coal-to-gas transition.

If – and our sources say not if but when – China does manage to turn on its LNG demand, the market will not hear a mere whisper of change, but rather a resounding bang.

As one lawyer puts it, at the right price, there's an insatiable demand for LNG in China. At the most recent North American Energy and Infrastructure Finance Forum hosted by IJGlobal and Euromoney Seminars in New York, the audience was told that Steelhead LNG believes it can ship LNG to China at $7 per MMbtu—that's about $0.50 to $1 cheaper than a Cheniere rep said it can currently achieve through its Gulf Coast facilities.

Should Steelhead make a positive FID in 2019, then competition in China could heat up just in time for a sharp rise in demand. Of course that all depends on whether the 'soft coup' to wrestle LNG purchasing power out of the hands of the NOCs.

Small bites

Ten to 15 years ago, people would laugh if a developer said they were planning to build out a half-ton to two and a half-ton train, but today a window is opening for the first time for smaller projects in the $2 to $4 billion range to compete in certain markets.

These smaller projects would be well-suited to meet the demand of markets like the Caribbean, which is turning toward LNG as a potential baseload replacement for heavy fuel oil, diesel and kerosene. Earlier this year, Jamaica closed financing on its Old Harbour power plant, storage facility and import terminal, which is hoped by developers to become a launch pad to bring LNG into the island region.

Turning sights back toward Asia, there is also an opportunity for smaller projects to serve a growing interest in small bite commitments as governments explore the potential for LNG as part of their own fuel mix.

Projects in the $2 to $3 billion range would not come close to covering the demand requirement of these potential buyers, we are told, but they would allow buyers who haven't invested yet to learn more about the US market as they evaluate whether big ticket purchases are a good fit. The smaller projects allow them to secure an upstream investment that they can use as a foothold to grow.

Turning Japanese

Whereas the first wave of major LNG export terminals in the US was largely supported by Japanese investors, deal trackers are seeing diminished Japanese presence nowadays. Rather, it is Korean and Chinese groups that are looking to scoop up the next round of opportunity.

These Chinese and Korean players are said to be meeting with every terminal and export developer in North America, drafting letters of intent and MoUs in an effort to secure some skin in the game.

Others circling US projects at the moment include Europeans, Indonesians and Indians, one deal maker said.

What next?

Lenders in the space are fairly certain that the next financing in the LNG space will be Corpus Christi Train 3. Sponsors are said to be aggressively marketing for the train and it appears to be the most advanced in terms of preparedness.

Elba Island is said to be the likely contender for next in line. It will be the first large-scale modular facility to come online if so.

Further out on the horizon, only time will tell whether incremental demand spikes will drive a new round of development.